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The proposed amendments result in the use of the current administrative costs in developing the administrative cost limit. The cost of the certified audit required in the proposed rule was moved outside of the administrative cost limit for the first year. The actual cost of the certified audit will be reported to the Department by July 31, 1985, and will be included in the payment rate.

Additionally, other costs which must be reclassified as a result of this rule such as central office property costs will be included in the development of the administrative limits. These changes address many of the objections and concerns about the administrative cost limit raised during the public hearing. The proposed amendment to Part 9553.0050, subpart 1, item A, subitem (1) is a reasonable method to develop limits and to compare costs to those limits because the costs are now classified in the same manner.

Also, the amendment proposed in Comment 22 reclassifies costs such as real estate and professional liability insurance, real estate taxes, and Minnesota Department of Health (MDH) and Department of Human Services (DHS) license fees to a special operating cost category which will result in the reimbursement of these costs at the actual cost based on invoices submitted by July 31 of each year. Reimbursing the actual cost is a reasonable alternative to address further concerns addressed by the public.

Another concern raised was that the limit should be based on a fixed dollar or per diem amount and not a percentage since a percentage would affect low cost providers disproportionally. The proposed amendment establishes two per diem limits. One for 20 or fewer licensed beds and one for more than 20 licensed

beds. As indicated in the Department's Statement of Need and Reasonableness, there are marked differences in administrative costs between these two size groups. Therefore, it is reasonable to group facilities in this manner. Furthermore, the proposed change does establish a fixed dollar (per diem) limit per licensed bed for each group.

Another objection raised dealt with the need to establish a limit for administrative costs based on the cost classifications in this proposed rule. The proposed amendment to page 40, line 4, accomplishes this by permitting the reclassification of operating and property costs pursuant to the proposed rule.

The suggestions to allow the actual administrative costs for one or two years and to do research in order to determine the necessary level of administrative costs do not meet the legislative mandate in M.S. 256B.501, subdivision 3 which requires the commissioner to develop limits on general and administrative costs.

The limit is based on the median cost per licensed bed plus 5%. The proposed limit is reasonable because the limit is prospective and management can take adequate steps to prepare and control a budget so that costs during the rate year do not exceed the limit. Also, the median reflects a point at which 50% of the providers spend less than that amount. The extra 5% increases the probability that a provider over the median will not have to revise its spending in the administrative cost category. In fact, a limit constructed in this manner allows any provider to come under the limit.

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Comment 35. Part 9553.0050, subpart 1, item A. Ms. Busch was concerned with the inability to net reductions in the program cost category against costs in the maintenance and administrative cost categories that are in excess of the historical rate limit. It is reasonable to exclude the program cost category from this net calculation because it would then be possible to increase maintenance and administrative costs by reducing program costs. This would be contrary to the intent of encouraging quality care. For example, a facility could trade a behavior analyst for management fees.

Ms. Busch also commented on the need to allow historical expenditures in the program area which may exceed the payment rates in that area for the same period of time. The Department agrees that the facility should have the flexibility to adjust its historical expenditures based on increased acuity of the resident population or the need to enrich the program offered to the residents. Therefore, the Department wishes to amend the rule as follows:

On page 39, line 30, strike the phrase "Except as provided in subitem (3), for" and insert "For"; on line 32, page 39, strike "program," and after the word "maintenance" strike ",".

Beginning on line 22, page 40, strike all of subitem (3). On line 27, page 40 strike "(4)" and insert "(3)", strike "subitems" and insert "subitem" and strike "and (3)".

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On page 40, line 33, strike the phrase "as limited according to item A,". On page 60, line 35, strike "subitems" and insert "subitem"; strike "and (3)". On page 62, line 1, strike "subitems" and insert "subitem"; on page 62, line 24, strike "and (3)". On page 62, line 23, strike "subitems" and insert, "subitem"; on page 62, line 24, strike "and (3)".

Comment 36. Part 9553.0050, subpart 2, item E. Commentors Ms. Rowland and Ms. Martin were concerned that the efficiency incentive takes into account expenditures which are not included as allowable costs and Ms. Martin believes that the application of the provision as amended is overly restrictive. The Department believes that the provision as amended remains unclear and, therefore, proposes the following amendment: page 42, line 7 after "If the" insert "reporting year's"; after "total" strike "historical", after "cost" insert "excluding special operating costs." The proposed amendment is necessary to clarify that the computation of the efficiency allowance is done by comparing the facility's actual expenditures for program, maintenance, and administration to the limits (rates times resident days) allowed pursuant to this rule. Since "historical operating costs" is a defined term which means operating costs after application of these rule parts, the word historical must be deleted. This amendment is necessary to insure that nonallowable costs are not reimbursed through the efficiency incentive. For example:

Limits (rates times resident days)	$150,000*
Actual Operating Costs	150,500*
Nonallowable Costs	1,000

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If the nonallowable costs are subtracted first ($150,500 -1,000 = 149,500) the result would be an "efficiency" of $500 (150,000 - 149,500). The facility in this scenario is not truly efficient because it has in fact expended allowable costs on nonallowable items. The facility should not be entitled to an efficiency incentive under this circumstance. To permit an efficiency incentive to be paid in this situation is unreasonable. The fact that the facility has obtained or used other sources to pay for the nonallowable cost should be irrelevant to this calculation. This is reasonable because to exclude nonallowable cost in the efficiency incentive calculation could result in some or all of the nonallowable cost being reimbursed through the efficiency incentive. Therefore, the amendments proposed at the public hearing and the amendment proposed above are reasonable and necessary to insure the proper application of the efficiency incentive.

Comment 37. Part 9553.0050, subpart 3. item A. Allan Baumgarten, from the office of the Legislative Auditor, indicated that the Department should not require facilities to violate State licensing rates and be cited for that violation in order to request a one-time adjustment. He suggested linking the one-time adjustment to the redetermination of need process. The Department agrees with this suggestion and wishes to amend the rule as follows: On page 42, line 25 after "commissioner" insert "or the Commissioner of Health." On line 26, after "9525.0430" insert "or parts 4665.0100 to 4665.9900; or when the federal government has issued a determination under 42 CFR, section 442."

On page 42, line 28, after "plans" insert, "or when the commissioner has determined a need exists based on a need re-determination plan approved pursuant to Minnesota Statutes 252.28 and rule parts 9525.0015 to 9525.0145

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(Emergency)". On line 30, delete "commissioner's" and after "deficiency" insert "or need". On line 35, after "deficiency", insert "or need". After "corrected", insert "or met". On page 43, line 4, after "deficiency" insert "or need"; and after "corrected", insert "or met".

On page 43, line 13, after "deficiency", insert, "or need"; after "corrected", insert "or met". On line 15, after "order", delete "issued by the" and insert "or determination". On line 16 delete "commissioner"; after "cites" delete "a" and insert "the"; after deficiency, delete "in program staff and a" and insert "or need".

On page 43, line 17, delete "copy of the Commissioner's determination of" and insert "in".

On line 20, after "order" insert "or need determination".
On line 24, after "deficiency" insert "or meet the need".

This amendment is necessary and reasonable to address changes in the program needs of residents.

Comment 38. Part 9553.0060 subpart 1, item C. Mr. Gee introduced Public Exhibit No. 8 listing investment per bed limits which, he claims, differ from the limits listed in this item of the proposed rule. The exhibit presented by Mr. Gee reflects recomputations of the investment per bed limits as adjusted by subitem (4); therefore, there is no inconsistency in the proposed rule.

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Mr. Gee and Ms. Martin also contended that these investment per bed limits do not reflect the current level of investment required in existing ICF/MR facilities. These limits have been increased by changes in the construction price index. In addition, these limits are adjusted for individual facilities every three years in accordance with subitem (4) to reflect additions, replacements or newly acquired depreciable equipment. The Department believes that the limits in this item are reasonable for both newly constructed and existing facilities. Therefore, the Department wishes to retain this provision, as published.

Comment 39. Part 9553.0060, Subpart 1, item E. Commentors (Seifert, Gee) expressed their concern that the funded depreciation requirements were too restrictive and resulted in excessive amounts of depreciation being funded. They stated that funds, once deposited, may never be withdrawn because of the 50% limitation on the amount to be withdrawn for purchase of capital assets. The Department believes the provision is necessary to provide for the repayment of debts and to replace capital assets. The amount of depreciation required to be funded decreases as the percentage of equity increases so that excessive amounts are not accumulated in that account. Additionally, once the accumulated balance, including interest income earned, exceeds the amount of outstanding debt, the amount of funded depreciation which exceeds the amount of outstanding debt may be withdrawn without regard to the 50% withdrawal limitation. Therefore, the balance in the funded depreciation account can, after debts are paid off, be withdrawn to purchase capital assets.

The Department believes this provision is necessary and reasonable and desires to retain the proposed rule as published.

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Comment 40. Part 9553.0060, subpart 3, item G, subitem (3), unit (b). Mr. Gee raised the concern that the cost of refinancing a balloon payment did not include the refinancing costs. The Department believes that the cost of reasonable refinancing expenses should be included in the refinancing of a balloon payment and proposes the following amendment to clarify that provision. Page 54, line 12 after "payment" strike "."; insert "except to the extent of refinancing costs such as points, origination fees, or title searches."

Comment 41. Part 9553.0060, subpart 5. Messers Sajevic, Larson, Seifert and Gee indicated that the capital debt reduction allowance is an insufficient reward for the accumulation of equity. Minnesota Statutes 256B.501, subdivision 3 directs the department to develop "incentives to reward the accumulation of equity." It is important to note that the law does not state that the department must give a return on equity. The department believes that the capital debt reduction allowance in combination with the treatment of interest income provides strong incentives to accumulate equity. Mr. Osell explained this interaction in detail on pages 63, 64 and 72 through 80 of the August 21 transcript. Mr. Seifert in Public Exhibit 12 on the page entitled Net Income shows that beginning in year 15 through year 35 except for years 30 and 31 the net income generated by the capital debt reduction allowance exceeds that which could be generated under Rule 52. In addition, Mr. Seifert's exhibit does not reflect the additional cash flow that can be

generated by investing unexpended funds generated through the capital debt reduction allowance and the depreciation allowance. As it was pointed out by Mr. Baumgarten, Rule 52 was designed to provide very high incentives to develop new facilities, hence the high levels of property reimbursement in the first years of operation. More development of ICF/MR facilities is not needed at present as indicated by the legislature's decision to impose a moratorium. The legislature also wanted limits on property costs, so it was not the legislature's intention to design a system that was equally or more generous than Rule 52. The proposed rule also allows for the generation of income which is not related to the expenses for the period such as the occupancy incentive (property expenses divided by 96% of capacity days rather than by resident days) and the efficiency incentive on operating costs (up to $2 per day). The Department believes that this provision in combination with other parts of the proposed rule sufficiently rewards the accumulation of equity and meets the legislative mandate. Therefore, the Department wishes to retain this provision as published.

Comment 42. Part 9553.0060, subpart 7. Ms. Rowland and Ms. Swanson expressed concerns regarding arm's-length lease or rental costs for agreements entered into before December 31, 1983 and subsequently renegotiated. They specifically were concerned about non-profit facilities that have very favorable lease agreements being unable to fund an increase in the lease when it is renegotiated. The Department agrees that it is necessary and reasonable to permit some justifiable increases. The Department proposes the following amendment:

On line 23, page 58, after "(4)", strike the remainder of line 23, and insert "Increases in lease or rental costs resulting from the renewal, renegotiation, or extension of a"; on line 24, page 58 strike "leases" and insert "lease", and strike "agreements" and insert "agreement"; on page 58, strike lines 25, 26 and 27, and insert "extent that the facility's property related payment rate does not exceed the average property related payment rate of all facilities in the state."

Ms. Swanson also raised the question of whether an increase in arm's-length rental of office space would be allowed under the proposed rule. The Department wants to correct the answer given at the hearing. Since central office rental is an administrative cost, any increase in an arm's-length lease would be allowed within the administrative cost limitations.

Comment 43. Part 9553.0070, subpart 4. Ms. Mulloy indicated that the effective date of the rule needs to be clarified. The Department agrees that Part 9553.0010 does not clearly state that the proposed rule will affect all rates issued on and after January 1, 1986, and proposes the following amendment: One page 1, line 9, after "for", delete "rate years beginning" and insert "payment rates established"; one page 1, line 10, delete "October" and insert "January". Ms. Mulloy also expressed lack of understanding of how the phase-in would work. Mr. Osell's explanation in the August 25 transcript reflects the correct interpretation of the phase-in. The Department feels that the proposed rule is clear and wishes to retain that provision as published.

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